

The City of Carlsbad Housing & Neighborhood Services
**A REPORT TO THE HOUSING
COMMISSION**

Staff: Scott Donnell
SENIOR PLANNER
Item No. 2

DATE: September 19, 2013

SUBJECT: Affordable Housing Impact Fee

I. RECOMMENDATION

That the Housing Commission **ADOPT** Housing Commission Resolution No. 2013-003 recommending the City Council **ACCEPT** the “Affordable Housing Impact Fee Nexus Study” prepared by Keyser Marston Associates, Inc., and dated September 2013 and **APPROVE** (1) an affordable housing impact fee, not to exceed \$20 per square foot, to be paid by developers of market-rate rental housing to offset the affordable housing demand caused by the construction of market-rate rental housing and (2) the “Construction Costs Index” (CCI) published by Engineering News Record as the index (with no ceiling) for fee level adjustment, all based upon the findings contained in the resolution.

II. BACKGROUND AND DISCUSSION

A. Overview

On March 20, 2012, the City Council held a workshop that included a discussion on housing issues. Among the workshop topics discussed were Carlsbad’s future housing growth and demographics and, most particular to this Housing Commission item, recent court decisions that affect affordable housing production.

The court rulings restrict the city’s ability to apply inclusionary requirements to rental units in the absence of a financial or regulatory incentive or concession and a contractual agreement (*Palmer/Sixth Street Properties, L.P. v. City of Los Angeles*). The rulings also impact how the city can impose fees to assist with the development of affordable housing (*Building Industry Association of Central California v. City of Patterson*).

Based on the workshop discussion, the City Council directed staff to return with proposals to address the city’s inability to apply inclusionary requirements to rental housing. One proposal was to present for City Council consideration a nexus study. The study would estimate the impact of market-rate rental housing on the need for affordable housing. Based on that analysis, the study would also identify a rental housing impact fee to apply to market-rate rental projects. This fee would be collected by the city from developers to facilitate affordable housing construction. Based on Council’s direction, staff has contracted with a consultant to prepare the study and recommend a fee.

B. Background

As with all California jurisdictions, Carlsbad has a state mandate to provide housing affordable to all economic segments, with an emphasis on housing affordable to individuals and families with lower incomes. In fact, the Regional Housing Needs Assessment estimates 1,605 lower income units are necessary to accommodate growth in Carlsbad during the next eight years. To implement this mandate and need, a goal of the city's current Housing Element is "new housing developed with diversity of types, prices, tenures, densities, and locations, and in sufficient quantity to meet the demand of anticipated city and regional growth."

"Affordable" housing, or housing affordable to lower (extremely low, very low, and low) income persons, is largely achieved in Carlsbad through application of the city's inclusionary housing ordinance. Since adoption of the ordinance in 1993, for example, developers have constructed more than 2,000 units of affordable housing with the majority (over 1,500 units) built to satisfy inclusionary requirements. Some of these units resulted from the application of inclusionary requirements to market-rate rental developments, such as the Marbella project near Plaza Camino Real and the Traditions project near Dove Library. Both apartment communities were completed in the mid-2000s.

In July 2009, the State Court of Appeals determined in the Palmer decision that local inclusionary requirements for rental units are pre-empted by state law (the 1995 Costa-Hawkins Rental Housing Act) regarding rent control. In 2010, Carlsbad amended its inclusionary standards to comply with this court ruling. Before the ruling, the city had applied its inclusionary requirements to both ownership and rental projects. Since the ruling and the amendment, rental projects have been approved and constructed without the requirement to provide inclusionary housing.

The second relevant court decision, the Patterson case, invalidated the City of Patterson's in-lieu affordable housing fee because "no reasonable relationship" was found between the construction of market-rate housing and the need for affordable housing. As such, instead of establishing fees based on a city's citywide need for affordable housing, affordable housing impact fees must be rationally related to the impact caused by market-rate housing.

Additionally, at the March 2012 City Council workshop, staff noted that Carlsbad demographic and land use trends point to an increase in multi-family construction, including apartments, along with a strong rental market and developer-interest in converting non-residential lands to apartment sites; furthermore, staff described that the majority of residential land in Carlsbad has been developed or planned, shrinking the opportunity for the city to apply its inclusionary requirements and realize affordable housing gains.

In light of the above noted constraints and trends as well as Council's direction, staff has contracted with Keyser Marston Associates, Inc., to prepare a nexus study and recommend a fee. The nexus study responds to the Patterson court case because it analyzes the nexus between new market-rate rental developments and affordable housing need and calculates a nexus-based affordable housing impact fee. The study with recommended fee is an attachment to the Housing Commission resolution.

Please note that the potential adoption of an affordable housing impact fee would be separate from and would not affect the city's Inclusionary Housing Ordinance found in Carlsbad Municipal Code Title 21. This ordinance requires all new ownership residential projects to set aside at least 15 percent of units so as to be restricted in terms of occupancy and affordability to lower income households. Subdivisions with fewer than seven units are allowed the payment of an in-lieu fee to fulfill their inclusionary housing obligations. The proposed affordable housing impact fee would apply to market-rate rental developments only, which are not subject to the City's Inclusionary Ordinance but nevertheless create a need for affordable housing.

Following the Housing Commission's review and recommendation, staff anticipates presenting this item to the City Council as a proposed ordinance. The ordinance would establish the affordable housing impact fee and related requirements. The ordinance would be incorporated into the municipal code through an amendment process.

C. Affordable Housing Impact Fee Nexus Study

The attached nexus study begins with a summary and recommendations section, which notes:

The underlying nexus concept is that the newly constructed market-rate rental units represent new households in Carlsbad. These households represent new income in Carlsbad that will consume goods and services, either through purchases of goods and services or by "consuming" governmental services. New consumption translates to new jobs; a portion of the jobs are at lower compensation levels, low compensation jobs translate to lower income households that cannot afford these market-rate units in Carlsbad and therefore need affordable housing.

Through text, tables and appendices, the nexus study explains the nexus concept. As a result of the construction of market-rate rental units, the study:

- Identifies the number of jobs and new worker households generated.
- Describes the kinds of jobs and incomes of new worker households.
- Reports the subsidy needed to produce and deliver a unit at the specified affordability level; the subsidy, or affordability gap, is the difference between the cost of development and the unit value supported by the rent that can be paid by a household at the specified income level (e.g., a rent affordable to a low income household).
- Discusses the affordable housing impact fee in terms of maximum supported fee amounts, potential fee levels for consideration, and a recommended fee.

The study provides this information for each of four different prototypes of rental units, which are representative of apartment construction that has occurred or would be expected to occur in Carlsbad. Each prototype reflects a different project density and unit size and mix. Thus, construction costs and affordability in terms of rent varies.

Although the proposed affordable housing impact fee would be separate from the inclusionary housing ordinance, the study uses terms (e.g., very low income) as defined in the ordinance.

Also, as the ordinance applies in most cases only to ownership projects, the study presents the ordinance's 15 percent inclusionary requirement as an objective for affordable housing production. The study also provides comparisons to the 15 percent inclusionary requirement, noting, for example, that the demand for affordable housing created by the construction of market-rate rentals exceeds this percentage requirement applicable to ownership projects.

This staff report provides only a summary only of some of the items discussed in the nexus study. Please refer to the KMA report for complete information.

D. Analysis

The nexus study reports maximum supported impact fees ranging from \$22,000 to \$26,900 per market rate unit or \$22 to \$32 per square foot, depending on the development prototype. However, while the study notes these fee amounts are the maximum supported by the nexus analysis, it also cautions that fee levels considered must take into account economic and real estate factors and must not be so onerous as to significantly constrain development activity.

Accordingly, the study presents the following three fee levels for consideration:

- *Nexus supported fee amounts* - Rather than charge a range of fees, the study notes the city is likely to adopt a single impact fee applicable to all market-rate rental housing, regardless of the product type. Appropriately, this fee would be the lowest of the maximums supported and identified in the study for the four prototypes. This fee would be \$22,000 per unit or \$22 per square foot.
- *Funding level required to develop 15% affordable off-site* – This fee level consideration estimates the funds needed by the city to build a stand-alone affordable rental project that is not on the same site as a market-rate rental project. Depending on the market-rate rental prototype, this fee would vary from \$14 to \$23 per square foot or an average of \$19 per square foot. KMA estimates that a fee adopted below this level would not enable the city to meet its 15 percent inclusionary objective.
- *Economic impact of incorporating 15% affordable housing on-site* – The study also considers the economic impact to market-rate rental developers that incorporate affordable housing on-site, such as a project where 15 percent of the units are rented at affordable rates and all other units are rented at market rates. KMA estimates the average economic impact is \$21,600 per unit or \$21 per square foot and notes “these figures represent the economic burden previously absorbed by the marketplace under the city’s Inclusionary Housing Ordinance prior to the Palmer decision.” As a reminder, the 2009 Palmer court case restricts the city’s ability to apply inclusionary requirements to rental projects.

KMA’s concluding recommendation regarding fees is that Carlsbad should not charge an affordable housing impact fee exceeding \$20,000 per unit or \$20 per square foot. Staff concurs. Further, staff recommends the fee should be charged on a per square foot versus per unit basis as this ensures fee equity regardless of unit size and may encourage development of smaller units, which could improve housing affordability.

Finally, the nexus study reports on a number of potential indices (fee escalators) that could be used to adjust the fee to keep it in line with future changing costs. The second of the indices identified in the report, the "Construction Costs Index (CCI)" published by Engineering News Record, has been recommended by the city's Administrative Services Director as that index (with no ceiling) is commonly used for other city impact fees.

III. ENVIRONMENTAL IMPACT

Proposed Housing Commission actions to recommend acceptance of the affordable housing impact fee nexus study and approval of the proposed fee and index for fee level adjustment are part of the steps necessary to amend the municipal code and incorporate the fee.

Per Municipal Code Section 19.04.070 A.1.c., code amendments that are minor and involve no physical modifications do not require environmental review because they would not have a significant environmental effect. Therefore, the project is exempt from the California Environmental Quality Act.

IV. EXHIBIT

1. Housing Commission Resolution No. 2013-003, including attachment: Affordable Housing Impact Fee Nexus Study, September 2013.